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No. 01-887

IN THE

Supreme Court of the United States

FRANK J. WSOL, SR., HUGH M. CORCORAN, ROBERT N. FALCO, NEAL J. LONDON, CHARLES SCHMALZ, PHILLIP STANOCH, AS TRUSTEES OF THE INTERNATIONAL BROTHERHOOD OF TEAMSTERS UNION LOCAL NO. 710 PENSION FUND, AND THE INTERNATIONAL BROTHERHOOD OF TEAMSTERS UNION LOCAL NO. 710 PENSION FUND,

Petitioners,

v.

FIDUCIARY MANAGEMENT ASSOCIATES, INC. AND EAST WEST INSTITUTIONAL SERVICES, INC.,

Respondents

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

PETITIONERS' REPLY MEMORANDUM

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TREATISE

G. Bogert and G. Bogert, *The Law of Trusts and Trustees*, 543 (2d ed. 1978) 7,8

I. Introduction

A. Capsule Summary of the Fund's Allegations and the Appellate Court's Analytical Framework

Petitioners, the I.B.T. Local Union 710 Pension Fund and its trustees (together, the "Fund"), hired Respondent Fiduciary Management Associates, Inc. ("FMA") to manage a stock portfolio. FMA, in turn, retained East West Institutional Services, Inc. ("East West"), ostensibly to serve as an introducing broker on Fund trades. In reality, East West acted as a conduit to help divert Fund money (packaged as brokerage commissions) in a sophisticated, prearranged kickback scheme. The scheme enriched FMA, the Fund's fiduciary, and other co-conspirators, but not the Fund's participants or beneficiaries. FMA benefited because it would not have been retained to manage Fund assets had it not surreptitiously agreed to knowingly direct commissions to East West, which then paid off corrupt Fund trustees.

This is what the Fund claimed, at least, in levelling breach of loyalty and prohibited transaction charges against FMA below. And this is what the Seventh Circuit Court of Appeals *assumed* in its opinion despite denying the Fund any monetary relief under ERISA 409(a), 29 U.S.C. § 1109(a). The Seventh Circuit wrote:

> If the newly discovered evidence that the [Fund] unavailingly pressed on the district court in [its] Rule 60(b) motion is credited, *not only would FMA not have gotten the business had it not retained East West as an introducing broker,* but FMA knew about the crooked relationship between East West and one of the [F]und's trustees. *But that is just to say that if the evidence is believed, FMA committed a very serious breach of its fiduciary duty. Even so,* ... FMA obtained no greater profit than it would have

obtained had it not retained East West.

Wsol v. Fiduciary Management Associates, Inc., 266 F.3d 654, 658 (7th Cir. 2001) (emphasis added), reproduced at A-5 of the certiorari petition.[1]

B. The Fund's Reasons for Granting a Writ Remain Valid: the Presumed Fiduciary Malfeasance Enabled FMA's Profits or Fees

The Fund's certiorari petition rests on this overarching proposition: if FMA indeed "committed a serious breach" of its duty of loyalty and engaged in prohibited transactions as the Seventh Circuit assumed, then it must disgorge the profits or fees[2] it realized from managing the Fund's portfolio. The Fund believes the plain language of ERISA § 409(a), among other authorities, supports this "if-then" proposition.

FMA opposes the Fund's certiorari petition, but its brief strains to reach the merits of the Fund's position and largely disregards the Fund's policy arguments. FMA initially maintains the Fund mischaracterizes the Seventh Circuit's analysis because at one point (specifically, the preface to the questions presented), the Fund's certiorari petition states the Seventh Circuit "accepted [FMA's breaches] as fact." While

[1]By virtue of this assumption, the Seventh Circuit ignored liability and procedural issues, leaving only one issue for resolution:

> The [Fund's consolidated] appeals raise a number of questions, *but one is dispositive, and so we ignore the rest*. The [Fund] cannot prevail *unless the breach of fiduciary duty* either imposed a loss on the plan or generated a profit for FMA "through use of assets of the plan" by FMA. 29 U.S.C. § 1109(a). [Additional citations omitted.] If the former, they are entitled to damages, and, if the latter, to the recovery ("disgorgement," as the cases call it) of FMA's profit on a theory of unjust enrichment.... The [Fund has] not established a basis for either remedy, however, and so they lose.

Wsol, 266 F.3d at 656, A-2 (emphasis added). The italicized language also demonstrates the Court considered disgorgement of FMA's profits as a potential remedy.

[2]FMA's opposing brief does not commit or confine the Fund to an election of profits or fees. Accordingly, and with the Court's permission, the Fund continues to seek the maximum amount recoverable under ERISA § 409(a), be it FMA's profits or fees.

standing by the accuracy of this statement, the Fund nonetheless cured any unintended double meaning on multiple occasions. FMA also contends that the Fund waived reliance on the "equitable or other remedial relief" clause of ERISA § 409(a) — even though section 409(a) was not only repeatedly cited, but central to the parties' arguments and the lower courts' resolutions.

On the merits, FMA primarily argues that disgorgement of profits or fees is inappropriate because its fees were reasonable and legitimately earned. Put another way, it argues its fees were not causally connected to fiduciary breaches. But this position presupposes fiduciary fidelity. FMA does not account for the fiduciary breaches assumed by the Seventh Circuit, glossing over the assumption that it "[would] not have gotten the business had it not retained East West as introducing broker...." 266 F.3d at 658, A-5.

This assumption poisons the legitimacy of FMA's profits and fees and infects FMA's analysis, as well as the Seventh Circuit's holding.[3] Absent the unlawful *quid pro quo* arrangement, FMA would have been in no position to reap any profits and generate any managements fees by servicing the Fund's portfolio. But for its misconduct, FMA would not have been retained.

The presumed breaches thus *enabled* FMA's profits and fees, trumping its argument and obfuscating the fund's questions presented, which essentially can be reduced to this: Under ERISA § 409(a), must FMA disgorge the management fees paid by the Fund or the derivative profits because they would not have been realized *but for* FMA's assumed complicity in an unlawful *quid pro quo* arrangement?

FMA's other effort to cast the Seventh Circuit's decision as uniquely factual or fact-bound is overstated and poorly

[3]The Seventh Circuit's holding is infected because it is contradictory. It is illogical to presume liability predicated on the use of plan assets, yet deny recovery of FMA's profits or fees under ERISA § 409(a) because plan assets were not purportedly used to generate the profits or fees. In the Fund's view, FMA does not address this contradiction, which is amplified in the Fund's certiorari petition at pp. 14-15, much less reconcile it.

conceived: overstated because it relies on District Court findings to sanitize its conduct; poorly conceived because the appellate court assumed liability. The certiorari questions presented by the Fund are hardly fact-bound. While the Seventh Circuit did not *disturb* facts found by the District Court, as FMA correctly notes, it did not *affirm or uphold* the District Court's fact-finding, either, on anything relevant to the core disgorgement issues framed by the Fund in its certiorari petition.[4] As the Seventh Circuit itself put it, all other issues save the remedy question were "ignore[d]". *See* footnote 1, *ante*, *quoting* from *Wsol*, 266 F.3d at 656, A - 2.

Perhaps FMA suggests that similar facts are unlikely to be litigated again. This is hopelessly naive. Kickback schemes will exist for as long as competitors for business opportunities exist. Indeed, Congress dedicated an entire provision, ERISA § 406(b)(3), 29 U.S.C. § 1106(b)(3), to kickbacks. *See, also, Ossey v. Marolda*, 1998 WL 67624 (N.D. Ill.), a case with many parallels to this action, including, allegedly, a small brokerage firm's retention by corrupt trustees in exchange for kickbacks. (Because *Ossey* is unpublished, ten copies of the opinion, appropriately bound and labelled, have been given to the Clerk.)

II. The Fund Accurately Described the Seventh Circuit's Assumption

As previously noted, FMA quibbles over *three words* chosen by the Fund to describe the Seventh Circuit's hypothetical construct. Specifically, FMA faults the Fund for the following italicized words which preface the questions presented in the Fund's certiorari petition: "The Seventh Circuit *accepted as fact* that a fiduciary...knowingly collaborated in a sophisticated securities kickback scheme...." Frankly, the Fund remains hard-pressed to understand exactly how these words mislead or mischaracterize anything. The Seventh Circuit said what it said. As the Fund

[4] In the Fund's view, the facts left intact by the Seventh Circuit (as not "clearly erroneous") do not inform a "profits" inquiry under ERISA § 409(a). Rather, they relate to the question of "loss" under this same provision.

reads the opinion, the court assumed FMA's liability, *arguendo*, to reach the ERISA § 409 remedy issues.

The Fund fully appreciates that any attempt to skew the record is the surest way to sabotage even the most worthy certiorari issue. It stands to gain little, if at all, by quibbling in-kind. It suffices to say, then, that any innuendo FMA perceives from the Fund's "accepted as fact" reference should have been erased by *the very next sentence* which indicates the Seventh Circuit "presumed" fiduciary breaches. This accords with FMA's own opposition brief. Compare the Fund's certiorari petition at i ("[d]espite presuming fiduciary breaches, the court did not award any remedy") with FMA's opposition brief at 14 ("[w]hile the Seventh Circuit's opinion assumes, *arguendo* only, fiduciary breaches by FMA").

III. The Fund Did Not Waive Any Arguments

FMA believes the Fund waived any argument that disgorgement of profits or fees is authorized by the equitable or remedial relief clause of ERISA § 409(a). But to do so, FMA overlooks frequent citations to ERISA § 409(a) in the proceedings below. It forgets its own discussion of disgorgement in previous appellate briefs. (*See* appendices A & B to this reply brief, paginated as A-R-1, *et seq.* and B-R-1 to distinguish the Fund's original appendix.) And FMA glosses over the Seventh Circuit's references to disgorgement and constructive trusts as alternative remedies against a malfeasant fiduciary. *Wsol*, 266 F.3d at 656, A - 2.

FMA's waiver contention thus belies the parties' arguments and the Seventh Circuit's own understanding of them. In this vein, *Harris Trust and Savings Bank v. Salomon Smith Barney*, 530 U.S. 238 (2000), proves instructive. Dismissing a waiver argument this Court wrote: "But even assuming that petitioners did not pellucidly articulate this theory before the Seventh Circuit, it appears to us that the Seventh Circuit understood the tenor of the argument...." *Id.* at 245, n. 2.

Regardless, FMA is legally wrong to suggest that a party may never offer new statutory *emphasis* or vary appellate arguments. The Fund's certiorari petition elaborates upon the

statutory authorization for disgorgement of profits or fees by parsing the "equitable or remedial relief" clause of ERISA § 409(a), the remedial statute which has always been, and remains, the centerpiece of the Fund's position. The focus on this clause may now be more refined, but the clause, as part of ERISA § 409(a), is not new authority.[5] Case law teaches that a party relying on a statute below is not barred from asserting new applications of the statute on appeal. *See, Chase Nat'l Bank v. U.S.*, 116 F.2d 625, 627-28 (2nd Cir. 1940). As this Court has instructed, "once a federal claim is properly presented, a party can make any argument in support of that claim; parties are not limited to the precise arguments they made below." *Yee v. Escondido*, 503 U.S. 510, 534 (1992)(citations omitted). This rule makes perfect sense. "Where the mind labours to discover the design of the legislature, it seizes everything from which aid can be derived." *U.S. v. Speers*, 382 U.S. 266, 277, n. 22 (1965)(electing to address the merits of a litigant's statutory comparison), *quoting U.S. v. Fisher*, 2 Cranch 358, 386 (1805) (Marshall, C.J.). Notably, FMA's brief fails to identify a single authority for its waiver argument.

Finally, close examination exposes faulty underpinnings for FMA's waiver argument. In their briefs to the Seventh Circuit, the parties never debated (and FMA never contested) the proposition that profits or fees causally connected to a demonstrable fiduciary breach and the use of plan assets should be restored under ERISA § 409(a). Rather, FMA *denied committing a fiduciary breach* (*i.e.*, the predicate act to any relief): its compensation was earned because of skillful portfolio management, not because of a *quid pro quo* arrangement calling for kickbacks in exchange for the Fund's business. (*See*, appendix A to this reply brief.) Alternatively, it denied receiving compensation from the Fund that was

[5]Moreover, the Fund's certiorari petition argues that FMA's assumed breaches trigger relief under the restoration of profits clause of ERISA § 409(a), as well as the "equitable or remedial" clause. *See*, 29 U.S.C. § 1109(a) which states in part: "[A breaching fiduciary] shall...restore to such plan any profits of such fiduciary which may have been made through use of assets of the plan by the fiduciary...." *Ibid.*

causally connected to any fiduciary breach, the use of plan assets, or both. (*Ibid.*)

Because restoration of profits causally connected to fiduciary breach and the use of plan assets was uncontested, the Seventh Circuit — which assumed both FMA's malfeasance and, apparently, a causal connection linking that malfeasance to FMA's profits — framed a profits issue the Fund could not have fully anticipated. In particular, the Seventh Circuit itself asked and answered whether profits are recoverable under ERISA § 409(a) if plan assets are not appropriated or invested in a risky scheme to enhance fees. The Fund deserves the opportunity in its certiorari petition to brief an issue first raised by the Seventh Circuit in its opinion, and the cases discussed above grant one.

IV. Conclusion

Stripped of diversions such as waiver and misrepresentation accusations, FMA's core argument seems to attribute some or all of the Fund's investment gains to the services it provided as an asset manager. Accordingly, FMA reasons, it is entitled to keep its profits and fees. This approach, of course, not only downplays contemporaneous bull market conditions, but it interposes economics as justification for its *presumed fiduciary misconduct.* This is akin to the ends justifying the means.

In the Fund's view, FMA's position rests on a legal/economic approach evidently embraced by the Seventh Circuit. This approach is not an adequate template for every case. It fails to account for human variables and dynamics. It is particularly wanting if, as here, *it fails to deter serious fiduciary misconduct* which causes incalculable, but certainly no less insidious, harm than that suffered by litigants with measurable economic loss. *See, Amalgamated Clothing and Textile Workers Union v. Murdock*, 861 F.2d 1406, 1411 (9th Cir. 1988)(disgorgement is ordered "to deter the fiduciary from engaging in disloyal conduct", the objective being "to make 'disobedience...so prejudicial...he and all other[s]...will be induced to avoid disloyal transactions in the future'")(*quot-*

ing G. Bogert and G. Bogert, *The Law of Trusts and Trustees*, § 543, at 218 (2d ed. 1978).

In the final analysis, Justice Jackson's words in *Mosser v. Darrow*, 341 U.S. 267 (1951), quoted in the Fund's certiorari petition at page 29, again bear on the questions presented:

> [I]t is difficult to say that there was no injury to the estate of the trust through these transactions. But equity has sought to limit difficult and delicate fact-finding tasks concerning its own trustee by precluding such transactions for the reason that their effect is often difficult to trace, and the prohibition is not merely against injuring the estate — it is against profiting out of the position of trust.

341 U.S. at 273.

FMA's opposition and the Seventh Circuit's decision represent an economics approach gone awry. Even if economics properly inform the analysis, the approach fails because the Fund paid FMA for loyalty. At the very least, isn't the Fund entitled to an economic remedy for FMA's assumed disloyalty?

For these reasons, the Court is respectfully urged to grant the Fund's Petition for a Writ of Certiorari.

Respectfully submitted,

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Appendix A

Excerpt from Respondent Fiduciary Management Associates, Inc.'s brief to the Seventh Circuit in Case No. 00-2703, styled Frank Wsol, Sr., et al., v. Fiduciary Management Associates, Inc. and East West Institutional Services, Inc.

From pp. 32-34

E. FMA Did Not Profit From its Use of E-W

The Teamsters claim entitlement to disgorgement of FMA's "profits" in the form of FMA's management fees, pursuant to ERISA Section 409, 29 U.S.C. § 1109. This argument is wrong as a factual matter. The District Court found no self-dealing as a finding of fact. (Teamsters Apndx. 20-29)

The Teamsters are also legally wrong because FMA's receipt of management fees bore no causal relationship to any alleged self-dealing by FMA. Section 409 of ERISA states, in pertinent part, that a fiduciary may be liable "to restore...any profits of such fiduciary which have been made through use of [plan] assets...by the fiduciary." 29 U.S.C.§ 1109. In interpreting Section 1109, this Court has emphasized if defendant fiduciaries' profits "resulted from defendants' own efforts, it in no way belongs to the trust." *Leigh v. Engle*, 858 F.2d 361, 366 (7th Cir. 1988).

The evidence established that all of FMA's management fees resulted from FMA's own efforts, not from FMA's decision to use E-W as an introducing broker. The testimony of various trustees established that FMA was hired and retained by the Teamsters on the merits of FMA's qualifications and performance record. (*E.g.*, Trustee Corcoran, Tr. 621-22; Trustee London, Tr. 741-42) This testimony supports the District Court's finding, as a fact, that the Teamsters' "trustees made their own independent decision to retain FMA." (Teamsters Apndx. 23) Similarly, there was no evidence E-W had influence over FMA's receipt of management fees. FMA earned its fees. Accordingly, even if there were self-dealing by FMA — and there was not — the Teamsters failed to

establish the requisite causal link between the alleged self-dealing by FMA and FMA's "profits."

The Teamsters rely on two District Court cases, *Ossey v. Marolda*, 1998 U.S. Dist. LEXIS 1767 (N.D.Ill., January 29, 1998), and *Wsol, et al. v. Great Northern Asset Management*, 114 F. Supp. 2d 720 (N.D. Ill. 2000). (Teamsters Br. 46) These cases are wholly distinguishable.

First, both *Ossey* and *Great Northern* were decisions in which the District Courts merely denied the defendant investment managers' motions for summary judgment because of material factual disputes. (*Id.*) Here the factual disputes have been resolved in a trial.

Second, in both *Ossey* and *Great Northern*, the plaintiffs raised a factual question about whether the defendant money managers received management fees because of improper influence on plan trustees. *Ossey*, 1998 U.S. Dist. LEXIS at *3-4; *Great Northern*, 114 F.Supp.2d at 724. Here, conversely, the evidence at trial showed that FMA earned its management fees only as a result of its own efforts, and E-W had nothing to do with the full Teamsters Board of Trustees' decision to hire and retain FMA.

Third, in *Ossey* and *Great Northern* the defendant investment manager's selection of the broker appeared to be contrary to its usual business practices. *Ossey*, 1998 U.S. Dist. LEXIS at *16; *Great Northern*, 114 F.Supp2d at 724-25. Here, by contrast, FMA acted consistent with its form ADV. Further, FMA's witnesses testified that FMA used introducing brokers other than E-W. (Tr. 286; 298)

Finally, in both *Ossey* and *Great Northern* there was evidence that the use of the broker either caused the plan loss or placed plan assets at risk. In *Ossey*, the broker was used to clear and execute trades, jeopardizing best execution. *Ossey*, 1998 U.S. Dist. LEXIS at *7-8. In *Great Northern*, the District Court accepted, for summary judgment purposes, the plaintiffs' experts' conclusion that the Teamsters obtained a worse price for fixed income products when E-W was used. *Great Northern*, 114 F.Supp.2d at 725. Here, by contrast to

Ossey and *Great Northern*, FMA never used E-W for clearance and execution, nor did the Teamsters suffer any loss. Accordingly, the Teamsters failed to establish that FMA profited from alleged self-dealing.

Appendix B

Excerpts from Respondent Fiduciary Management Associates, Inc.'s brief to the Seventh Circuit in Case No. 01-1685, styled Frank Wsol, Sr., et al., v. Fiduciary Management Associates, Inc. and East West Institutional Services, Inc.

From p. 17

...Nor does the Roach Declaration contain any facts that would entitle the Teamsters to a disgorgement of FMA's "profits" in the form of FMA's management fees.

From p. 39

Similarly, the Roach Declaration does nothing to enhance the Teamsters' claim that they are entitled to disgorgement of FMA's "profits" in the form of FMA's management fees, pursuant to ERISA Section 409, 29 U.S.C. § 1109.